Suspension of Insolvency and Bankruptcy Code

Why in news?

The Union Cabinet has cleared the proposal to suspend the Insolvency and Bankruptcy Code (IBC) for 6 months, and it can be extended up to an year.

What is the IBC essentially?

- Insolvency and bankruptcy code 2016 was introduced to resolve the bankruptcy crisis in corporate sector.
- Under IBC, either the creditor (banks) or the loaner (defaulter) can initiate insolvency proceedings.
- It is done by submitting a plea to the adjudicating authority, the National Companies Law Tribunal (NCLT).
- According to IBC, a financial creditor holds an important role in the corporate insolvency process.
- The Committee of Creditors (CoC) under IBC includes all financial creditors of a corporate debtor.
- The CoC will appoint and supervise the Insolvency Professional.
- It has the power to either approve or reject the resolution plan to revive the debtor, or to proceed to liquidate the debtor.

What is the COVID-19-led scenario?

- Companies are facing significant disruption due to the nationwide lockdown among other COVID-19-related measures.
- The government is also working on a special resolution framework for micro, small, and medium enterprises (MSMEs).
- The threshold for triggering the insolvency process has been increased substantially for these.
- The RBI has also allowed a moratorium on all term loan instalments till August 2020-end.
- All the above measures are designed to extend relief to businesses in these extraordinary times.
- However, policy-makers would do well to account for the unintended consequences as well.
- E.g. banks are worried that the moratorium on repayment of loans could affect the credit culture

- It might well lead to higher non-performing assets (NPAs).

How significant is IBC?

- The implementation of the IBC is one of the biggest reforms in recent years and must be preserved.
- Once economy returns to normalcy, the IBC framework would be required to reallocate capital from weaker firms to more productive ones.
- A delay in this process would affect the pace of recovery.

What are the uncertainties with IBC suspension?

- In the context of the IBC, it is important that the government involve the RBI and large banks.
- They will have to collectively decide on the ground rules with utmost care and clarity.
- E.g. if the cut-off date is March 1, 2020 what would happen to companies that might have defaulted before that should be clarified.
- Also, criteria for differentiating borrowers hurt by COVID-19 from those impacted by other factors should be specified.
- Economic indicators suggest that businesses started facing difficulties much before the lockdown was announced.
- So, what will happen to firms that had defaulted and lenders were preparing to start the proceedings under the IBC is a big question.
- Notably, the resolution of such accounts will help unlock funds, which can be used by banks for further lending.
- In all, resolution might become a bit difficult because of economic uncertainty.
- However, it cannot be a reason for suspension.
- A blanket suspension would not work as firms facing difficulties may themselves want to file for bankruptcy resolution.

What is a better way ahead?

- The Indian economy is largely expected to shrink in the current financial year.
- Lower sales and operating profits will make debt servicing difficult.
- So a large number of firms may not be in a position to service loans even after the moratorium period.
- It is thus widely expected that the RBI would allow a one-time restructuring of debt.
- Therefore, the government will need to work with the RBI in framing the IBC suspension mechanism.

- The NPAs are likely to rise in general because of economic disruption.
- But, policy-makers must make sure that the banking system is not put under excessive pressure.
- This is imperative because otherwise it could threaten the country's financial stability and affect economic recovery.
- It must also be ensured that IBC suspension does not end up affecting government's efficacy in the medium term.

Source: Business Standard

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